(5) The Commissioner of Internal Revenue has applied for a writ in the *Reynolds* case, No. 328. If that writ is granted, such action would be an added reason for granting this application.

Conclusion.

Wherefore, it is respectfully submitted that the petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Third Circuit should be granted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1938

No. 385

FIRST CHEROLD CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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No.

FIRST CHROLD CORPORATION, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

The petitioner, by counsel, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Third Circuit entered in the above-entitled cause on May 26, 1938, affirming a decision of the United States Board of Tax Appeals, and order of the court of June 28, 1938, denying petition for rehearing filed June 24, 1938.

Opinion Below.

The opinion of the Board of Tax Appeals (R. 16) is unreported. The opinion of the Circuit Court of Appeals (R. 33) is reported in 97 F. (2d) 22.

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Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 26, 1938 (R. 36). Thereafter, and on June 24, 1938, petitioner filed a petition for rehearing with the Circuit Court, which was denied on June 28, 1938 (R. 47). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

The following are the questions involved:

(a) Whether the petitioner was dealing in its own capital stock.

(b) Whether the petitioner, a corporation, realized gain in reselling its own capital stock, and if so, then—

(c) Whether the gain arose in the year when the petitioner bought its outstanding capital stock (as petitioner contends under *United States* v. *Kirby Lumber Company*, 284 U. S. 1), or in a later year when petitioner sold an equal number of shares (as held by the Circuit Court of Appeals).

Statement.

The facts as found by the Board of Tax Appeals (R. 16, et seq.) are substantially as follows:

The petitioner corporation was organized on April 8, 1930, for the purpose of dealing in stocks listed on the New York Stock Exchange (R. 16-17). The petitioner's stock was not listed on any exchange (R. 17). Mr. Gerald M. Loeb, a partner of E. F. Hutton & Company of New York City, formed and managed the petitioner corporation from the time of its organization through the taxable year (R. 17). At the time the corporation was formed it promised its stockholders that if at any time they wanted to withdraw from the company for any reason the petitioner would take their stock off their hands (R. 17). During the

break in the market in 1931 and 1932 the petitioner, pursuant to its promise to its stockholders, purchased from them 2,326 shares of its own stock as against 420 shares sold (R. 18). The purchases and sales of stock were made on the basis of liquidating value, plus or minus a marginal difference to take care of inaccuracies (R. 20).

During 1933, when market conditions were somewhat better, it sold 662 shares (as against none purchased) for $92,593.05 (R. 19-20). In filing its tax return petitioner reported no gain or loss from buying and selling its own stock, and the regulations of the Commissioner, as approved by the Secretary of the Treasury, at that time were to the effect that a corporation realized no gain or loss in buying and selling its own stock, the pertinent provision thereof, Article 66 of Regulations 77, being set out in full at page 5 herein.

The Commissioner in auditing the petitioner's return determined a deficiency against the petitioner, and in his formal notice of deficiency (R. 7-11) found that the petitioner had realized a profit of $27,944.65, on the theory that during 1933 petitioner had sold 662 shares of common stock for $92,593.05, and that petitioner in 1931 had acquired an equal number of shares at a cost of $64,648.40 (R. 10, 20).

When the petitioner purchased the shares of its own stock, they were charged to an account designated "Treasury Stock" in the amounts paid therefor, and were carried as such on the liability side as a deduction from capital stock authorized and issued. Purchases of stock or securities, other than shares of its own capital stock were carried in separate accounts, on the asset side, as assets (R. 20).

From the determination of the Commissioner of Internal Revenue the petitioner appealed to the United States Board of Tax Appeals (R. 3-13), claiming (a) that it was not "dealing" in its own stock, and therefore realized no taxable profit, and (b) that if the petitioner was "dealing" in its own stock, then such gain as was realized occurred in 1931, when the stock was purchased, in that, under the fol-

was assigned for hearing immediately following No. 328, *Helvering, Commissioner* v. *R. J. Reynolds Tobacco Company.* The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

The following are the questions involved:

(a) Whether the petitioner was dealing in its own capital stock.

(b) Whether the petitioner realized gain in reselling its own capital stock, and if so, then—

(c) Whether the gain arose in the year when the petitioner bought its outstanding capital stock (as petitioner contends under *United States* v. *Kirby Lumber Company*, 284 U. S. 1), or in a later year when petitioner sold an equal number of shares (as held by the Circuit Court of Appeals).

Statutes Involved.

There is no provision in the Revenue Act of 1932 dealing specifically with the subject matter. As originally issued on February 10, 1933, Article 66 of Regulations 77 (promulgated under the 1932 Act) provided as follows:

> "*Art. 66. Sale by corporation of its capital stock.*— The proceeds from the original sale by a corporation of its shares of capital stock, whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation pur-

lowing statement by the Supreme Court in *United States* v. *Kirby Lumber Company*, 284 U. S. 1, 3—

> " * * * As a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here * * *."

gain or loss occurred when petitioner repurchased the certificates of stock in 1931 (R. 6).

The case was tried before the Board on the foregoing issues. The Board decided for the respondent and entered orders accordingly. Thereafter an appeal was taken to the Circuit Court of Appeals for the Third Circuit (R. 24-27), where the decision of the Board was affirmed.

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

(1) In holding that the petitioner was dealing in its own capital stock.

(2) In holding that the petitioner realized a taxable profit in 1933 in reselling some of its capital stock purchased in 1931.

(3) If, as a matter of law, the petitioner realized gain or loss in buying and selling its own stock, then the court erred in not holding that the profit, if any, was realized in 1931 when petitioner repurchased its stock and not in 1933 when the stock was resold.

Reasons for Granting the Writ.

(1) The decision of the court below is in direct conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *E. R. Squibb & Sons* v. *Helvering*, 98 F. (2d) 69, and the decision by the Circuit Court of Appeals

for the Fourth Circuit in *R. J. Reynolds Tobacco Company* v. *Commissioner*, 97 F. (2d) 302.

In those two cases, as well as in the instant case, the taxpayers were corporations which had resold some of their own capital stock at a price in excess of the price at which it had been redeemed. Both the Second and the Fourth Circuit Courts of Appeals held that a corporation does not realize a gain or sustain a loss upon reselling its capital stock.

(2) The decision below is erroneous. It disapproves the regulations issued by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. Article 66 of Regulations 77, promulgated on February 10, 1933, provided in part as follows:

> "Art. 66. Sale by corporation of its capital stock.—* * * If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See Article 176.)"

This Treasury Regulation was in effect at the time the transactions here in question took place. The Regulation was not a new one, but was based on a long established administrative practice to the same effect, evidenced by the following regulations and rulings, among others:

Regs. 45, Arts. 542 and 563, Rev. Act of 1918,
Regs. 62, Arts. 543 and 563, Rev. Act of 1921,
Regs. 65, Arts. 543 and 563, Rev. Act of 1924,
Regs. 69, Arts. 543 and 563, Rev. Act of 1926,
Regs. 74, Arts. 66 and 176, Rev. Act of 1928,
Regs. 77, Arts. 66 and 176, Rev. Act of 1932,

chases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)"

Subsequently to the decision of the First Circuit in the case of *Commissioner* v. *S. A. Woods Machine Company*, 57 F. (2d) 635, the Commissioner amended the regulations by T. D. 4430, XIII-1 C. B. 36 (May 2, 1934) to read as set out at pages 10-11 herein.

Statement.

The facts as found by the Board of Tax Appeals (R. 16, *et seq.*) are substantially as follows:

The petitioner corporation was organized on April 8, 1930, for the purpose of dealing in stocks listed on the New York Stock Exchange (R. 16-17). The petitioner's stock was not listed on any exchange (R. 17). Mr. Gerald M. Loeb, a partner of E. F. Hutton & Company of New York City, formed and managed the petitioner corporation from the time of its organization through the taxable year (R. 17). At the time the corporation was formed it promised its stockholders that if at any time they wanted to withdraw from the company for any reason the petitioner would take their stock off their hands (R. 17). During the break in the market in 1931 and 1932 the petitioner, pursuant to its promise to its stockholders, purchased from them 2,326 shares of its own stock as against 420 shares sold (R. 18). The purchases and sales of stock were made on the basis of liquidating value, plus or minus a marginal difference to take care of inaccuracies (R. 20).

During 1933, when market conditions were somewhat better, it sold 662 shares (as against none purchased) for $92,593.05 (R. 19-20). In filing its tax return petitioner reported no gain or loss from buying and selling its own

Law Opinion 296, 5 C. B. 210.
Law Opinion 426, 5 C. B. 210,
Law Opinion 1035, 2 C. B. 132, 133,
Law Opinion 1035, revised, 3 C. B. 160, 162,
A. R. R. 693, 5 C. B. 207,
A. R. R. 799, I-1 C. B. 374,
I. T. 1198, I-1 C. B. 275,
I. T. 1736, II-2 C. B. 274,
I. T. 1802, II-2 C. B. 267,
Solicitors Memorandum 2205, III-2 C. B. 244.

(3) The sale of treasury stock by a corporation is a capital transaction upon which gain or loss is not recognizable for tax purposes. When a corporation acquires its own stock it has not purchased an asset—it has satisfied a liability; a capital rather than a debt liability it is true, yet in the strictest sense of the word a liability. A share of stock is representative of an ownership interest in the corporation itself. When stock is reacquired by the corporation, the stock does not take the place of the assets exchanged therefor. In fact the corporation has less than it had before. True, each share of stock still outstanding represents a greater proportionate interest in the remaining assets, but this is because the capital liability of the corporation has been satisfied in part and the ownership interest of the stockholders in the assets has shifted.

When treasury stock is retired and new shares are issued, the corporation acquires new capital and assumes an additional capital liability. The liability is the obligation of the corporation, through its officers and directors, to account to its shareholders for its use of the assets in accordance with the law and its charter. From the standpoint of the corporation it is a purchase rather than a sale. And the purchase is accomplished not by an exchange of assets, but by the creation of a capital liability, because in no real sense was the treasury stock an asset or a liability.

Stock reacquired by the issuing corporation may be either retired or allowed to remain in the treasury. In the

stock, and the regulations of the Commissioner, as approved by the Secretary of the Treasury, at that time were to the effect that a corporation realized no gain or loss in buying and selling its own stock, the pertinent provision thereof, Article 66 of Regulations 77, being set out in full at pages 2-3 herein.

The Commissioner in auditing the petitioner's return determined a deficiency against the petitioner, and in his formal notice of deficiency (R. 7-11) found that the petitioner had realized a profit of $27,944.65, on the theory that during 1933 petitioner had sold 662 shares of common stock for $92,593.05, and that petitioner in 1931 had acquired an equal number of shares at a cost of $64,648.40 (R. 10, 20).

When the petitioner purchased the shares of its own stock, they were charged to an account designated "Treasury Stock" in the amounts paid therefor, and were carried as such on the liability side as a deduction from capital stock authorized and issued. Purchases of stock or securities, other than shares of its own capital stock were carried in separate accounts, on the asset side, as assets (R. 20).

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> "* * * As a result of its dealings it made available $137,521.30 assets previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here * * *."

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The Circuit Court of Appeals erred:

(1) In holding that the petitioner was dealing in its own capital stock.

(2) In holding that the petitioner realized a taxable profit in 1933 in reselling some of its capital stock purchased in 1931.

(3) If, as a matter of law, the petitioner realized gain or loss in buying and selling its own stock, then the court erred in not holding that the profit, if any, was realized in 1931 when petitioner repurchased its stock and not in 1933 when the stock was resold.

Summary of Argument.

I. The sale of treasury stock by a corporation is a capital transaction upon which gain or loss is not to be recognized for tax purposes. *Eisner* v. *Macomber,* 252 U. S. 189; *Appeal of J. H. Johnson, et al.,* 19 B. T. A. 840 (1930), affirmed C. C. A. 5, 56 F. (2d) 58, certiorari denied 286 U. S. 551 (1932).

II. The regulations of the Treasury Department from 1909 through the taxable year here in question specifically provided that a corporation realizes no gain or loss in buying or selling its own stock. In view of the repeated reenactments by Congress, without change, of the various revenue laws, the Treasury Department's construction is not to be overturned or overruled except for weighty rea-

latter event it is not an asset any more than a bond is an asset of the obligor. Its only value is a potential one, determined upon reissue by the real assets of the corporation. Authorized but unissued stock has the same character of exchangeable value, yet it would not be called an asset. Treasury stock does not differ from authorized and unissued stock. It does not carry voting power and it has no dividend rights. It cannot represent any interest in the corporation or in the assets of the corporation. Both the New York Stock Exchange and the Securities & Exchange Commission recognize this when they prohibit a corporation from carrying treasury stock as an asset.

In short, when a corporation sells its treasury stock it is deriving capital and not deriving a profit from capital. Capital derived is not taxable as income; it is the gain derived from capital that is taxable. *Eisner* v. *Macomber*, 252 U. S. 189. Thus when a corporation sells its treasury stock it is doing nothing more than deriving additional capital.

(4) The profit, if any, arose in 1931, when the petitioner purchased its outstanding stock and not in 1933 when the treasury stock was resold. *United States* v. *Kirby Lumber Company*, 284 U. S. 1. In the *Kirby Lumber Company* case the Supreme Court held that a corporation realized a taxable gain when it had repurchased some of its outstanding bonds at a price less than the issuing price of the bonds. If corporation A realizes a profit of $100 in purchasing for $900 one of its outstanding bonds which had been sold for $1,000, then on reason and principle Corporation B would have a $10 profit if it buys in for $90 one of its shares of stock which had been sold for $100. Applying that principle to the facts in this case, any gain or loss which First Chrold Corporation realized must have occurred in 1931 when it purchased the outstanding stock which was issued when the corporation was formed in 1930.